A
GREEN PAPER
ON
OUR HEALTH CARE SYSTEM
EXPENDITURES AND FUNDING

JOINTLY RELEASED BY:

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INTRODUCTION

The Government of Newfoundland and Labrador has made, and continues to make, a significant financial commitment to programs and services designed to maintain and improve the general health of the people of Newfoundland and Labrador. In the past, much has been accomplished. However, as we look to the future, thoughtfully and realistically planning for the years ahead, we must recognize that there are many demands to be met in providing health care services to the people of Newfoundland and Labrador.

Reviewing the organization of health care, addressing the inequities that remain, managing the Province's budget to finance the growing cost of health care services: these are challenges that face the Government and the people of this Province. They are made more acute by a decline in the growth rate of federal Established Programs Financing (EPF) contributions to health care as well as post-secondary education. As we enter the second half of this decade, the Province must meet such challenges with effective initiatives. There are no magic solutions: what is required is a determined effort on the part of Government assisted by the best advice offered by interested groups and the general public.

What is the purpose of this policy paper?

It was announced in the May 1985 Budget that the Government of Newfoundland and Labrador would be issuing a policy paper to give detailed attention to health care expenditures and the means of financing them. This paper has been prepared to give information and, more importantly, to stimulate discussion. It is designed:

- to give an overview of the Province's health care system;
- to provide information on the general health of the people of the Province;
- to outline the Government's current financial circumstances;
- to explain current reductions in health care funding by the Federal Government and resulting financial constraints; and,
- to invite discussion on the fiscal options available to Government.

It should be noted that this policy paper concerns itself with the particular impact of the slowdown in the growth of federal financial support for the provincial health care system and on measures to deal with this slowdown. This does not mean that Government is unconcerned with the potential repercussions of the reduction in the EPF growth rate on post-secondary education funding. The impact of these lower growth rates on post-secondary education is equally of serious concern to Government and is being dealt with by means separate from this policy paper. Funding for post-secondary education includes grants to Memorial University (including post-graduate programs for medical doctors); the Institute of Fisheries and Marine Technology; the College of Trades and Technology; the vocational schools throughout the Province; and the community college in Stephenville. Of the total expenditure allocations by the Government of Newfoundland for health care and post-secondary education in 1985-86, approximately 80 percent is spent on health care and 20 percent on post-secondary education.

Historically, the governments of Canada, at both the provincial and federal levels have made policy papers available to the general public as a method of inviting discussion and initiating participation in the formation of public policy. This Green Paper sets out a series of options for discussion without any particular policy preference or position being adopted.

This is not a paper on the operations of the health care system which was the subject investigated by the Royal Commission on Hospital and Nursing Home Costs. Government has endorsed the recommendations of the Royal Commission and these are being implemented on a cooperative basis by the Department of Health and the association representing hospitals and nursing homes throughout the Province. The Royal Commission concluded that the existing human and financial resources in the health care system must be redeployed more effectively before any expansion of funding takes place. The Department of Health and the individual health care institutions have been working assiduously to this end since receiving the report of the Royal Commission. It is important that both Government and the health care institutions continue to pull together and meet economic and fiscal pressures in a responsible manner. This paper focuses attention on the funding required by the health care system, in light of the recommendations made by the Royal Commission and particularly in light of the reduction in the EPF growth rates.

What is my role as a Newfoundlander or Labradorian in this process?

The Government has taken the responsible action of providing you with an informative policy paper. It is now your responsibility to assess carefully the options described in the paper, or other possible options, and to give Government your views.

How and when can I participate?

The Government is seeking written briefs on this policy paper. All briefs should be submitted to Government no later than February 28, 1986. Briefs can be sent to the Honourable John F. Collins, F.R.C.P.(E.), Minister, Department of Finance, Confederation Building, St. John's, Newfoundland, A1C 5T7. Anyone wishing to present a brief, either orally or written, should make arrangements as soon as possible by telephoning Mr. Edward Power, Assistant Deputy Minister, Department of Finance at 576-2946.

EXECUTIVE SUMMARY

Almost one of every four dollars spent by the Government of Newfoundland and Labrador is spent on health care. In 1985-86, health care expenditures are expected to reach $539 million or almost $930 per capita. Over the past ten years the most significant growth areas have been hospital services and facilities, physician fees, and services to senior citizens. In the years ahead the chronic needs of a gradually aging population and the acute care needs of a widely dispersed population will place increasing pressures on the health care budget.

The Government's commitment to health care has been one of the major factors which has allowed the general health of the population of Newfoundland to reach a level which compares very favourably with that in the rest of Canada. Mortality rates in the Province have been reduced to one of the lowest in Canada and life expectancy for both males and females is higher than the Canadian average.

During the past five years budgetary pressures have forced Government to place controls on the growth in health care expenditures and to carry out improvements for efficiency wherever possible. Many of these measures were recommended by the Royal Commission on Hospital and Nursing Home Costs (which reported in February, 1984) and have been implemented or will be in the near future. Examples of these measures are the following: global budgeting for hospitals and nursing homes; temporary freezes on hospital and nursing home budgets; freezing of salaries and fees for physicians; implementing incentive plans to encourage hospitals and nursing homes to save; developing more outpatient clinics and expanding home care and community support services; and fostering the concept that one hospital or nursing home board can operate two or more institutions and avoid duplicating services.

Despite all of these measures, Government still faces a number of significant problems in the funding of health care. Of particular concern to the Newfoundland Government are the continuing reductions in the rate of growth of fiscal transfers from the Government of Canada. These transfers are received through the Established Programs Financing (EPF) arrangements. Adjustments in the past have combined to reduce transfers to the Province for health care and post-secondary education by an annual average of $29 million from 1982-83 to 1986-87. Over the next five years more reductions in the rate of growth of EPF transfers are planned by the Federal Government. These, it is estimated, will result in a further loss to the Province of $128 million, or an average of approximately $25 million per year.

This Green Paper reviews a range of options available to Government to offset this reduction in the rate of growth of EPF transfers. These options include — privatization, expenditure changes in the health area, deficit financing and the tax system.

The evidence in Canada and the United States that private enterprise can manage hospitals and nursing homes more cost-effectively than publicly operated facilities is debatable. The options of user fees for purely medical and surgical services charged by hospitals and extra-billings charged by doctors are not available to Government because for every dollar collected in this manner the Federal Government would deduct a dollar from EPF transfers.

Further changes in health care expenditures are possible (beyond the measures being implemented as recommended in the Royal Commission on Hospital and Nursing Home Costs), but the types of changes necessary to achieve major savings would probably result in significant reductions in services, short of essentials.

Every effort has been made in the past to finance the operating expenditures of Government through operating revenues and thereby limit operating deficits to an absolute minimum. Even though the Newfoundland Government has been able to limit the rate of growth in its per capita public sector debt over the past decade to a level below most other provinces, our per capita debt is still relatively high. Nevertheless, deficit financing would avoid tax increases and serious program reductions, but only in the short term.

The current taxation system is described in the paper. Five principles should be used to guide the choice of tax measures — equity, efficiency, neutrality, certainty and convenience. In making a choice, it must be borne in mind that tax rates are relatively high in Newfoundland as compared with those in other provinces. There are three main reasons for these higher rates: Newfoundland's fiscal (revenue-generating) capacity is only 60 percent of the national average; the Newfoundland Government provides services such as education, transportation and police protection which are provided by municipal/local governments in some of the other provinces; and Newfoundland's resource revenues, primarily water power rentals income, are low compared to other provinces.

The Province's major tax sources are retail sales tax (RST), personal income tax, Newfoundland Liquor Corporation profits, gasoline tax, corporate income tax, tobacco tax, mining taxes and royalties, and fees and licences.

A wide range of personal and business tax exemptions are provided to reduce tax regressivity, to make businesses more competitive, to stimulate business development and create jobs.

Some additional tax measures used in other provinces are: personal income surtax on higher income earners, corporate capital tax on all corporations above a certain size, health insurance premiums and a payroll tax.

The purpose of this Green Paper is to lay before the general public the information needed to analyze all of the possible options. Reactions to the paper are being sought.

CHAPTER I

OUR HEALTH CARE SYSTEM

What is meant by health care?

Health care means different things to different people. It could be defined as a system which supplies a broad range of services and products used by patients or consumers. It addresses the concerns of patients or users of hospital and medical facilities. In so doing it contributes to the general health, or health status, of the population.

How does our general health or health status compare with that of other provinces?

The health status of the population of Newfoundland compares very favourably with that of the rest of Canada. Our overall mortality rates (age standardized) are slightly below the Canadian average. Over the past few years there has been a significant reduction in our infant mortality rate. Today, only two provinces have a lower infant mortality rate than Newfoundland. Likewise, morbidity or illness rates (age standardized) for males and females within the Province compare favourably with the Canadian average, and the life expectancy for both males and females in the Province is higher than the Canadian average.

Many factors account for our favourable health status including advances in the control and prevention of infectious diseases. As well, a significant commitment of funds by Government to health care has contributed immensely to these achievements. Examples of recent benefits arising from expenditures undertaken by Government are the new School of Medicine at Memorial University; the large increase in the number of physicians and other medical personnel working in the Province; and the development of many new programs, procedures and special care units in hospitals and nursing homes in all regions of the Province.

How much money does the Government of Newfoundland and Labrador spend on health care?

In 1985-86 almost one of every four dollars of the total provincial budget will be spent on health care. Total expenditures, both operating and capital, are budgeted at $539 million — nearly $930 for every citizen of our Province. This compares with $345 per capita in 1975-76, giving a growth of 10.9 percent per annum over the 10-year period.

How does this record compare with that of other provinces?

Other provinces are spending more on a per capita basis. However, as a percentage of our Gross Domestic Product (GDP) the Government of Newfoundland spends 8.8 percent on health care in comparison with a Canadian average

of 6.3 percent. The Government of Newfoundland and Labrador is thus devoting a significantly larger portion of its resources to health care than the other provinces. Two major factors help to explain this larger ratio: Newfoundland's GDP on a per capita basis is only 60 percent of the Canadian average, and Newfoundland has been striving to catch up to the quality of health services provided in provinces much longer in Confederation.

These expenditures on health care fall into six broad categories (see Table I below).

TABLE I
Health Care Expenditures
By Major Category

Category	Amount 1985-86 Budget ($ million)	Share of Total Health 1985-86 Budget (%)
Hospital Services & Facilities	360.6	67
Physician Fees & MCP Admin.	71.7	13
Institutional and Other Services to Senior Citizens	56.0	10
Departmental Health Care and Assistance Programs	36.8	7
Preventative Public and Community Health	10.6	2
Departmental Executive and Support Services	3.7	1
	539.4	100

1. Hospital Services and Facilities ($360.6 million)

This major group includes the cost of operating the Province's 36 hospitals, eight nursing stations and 80 clinics ($328 million) plus amounts budgeted for equipment and the renovation and construction of facilities.

2. Physician Fees and MCP Administration ($71.7 million)

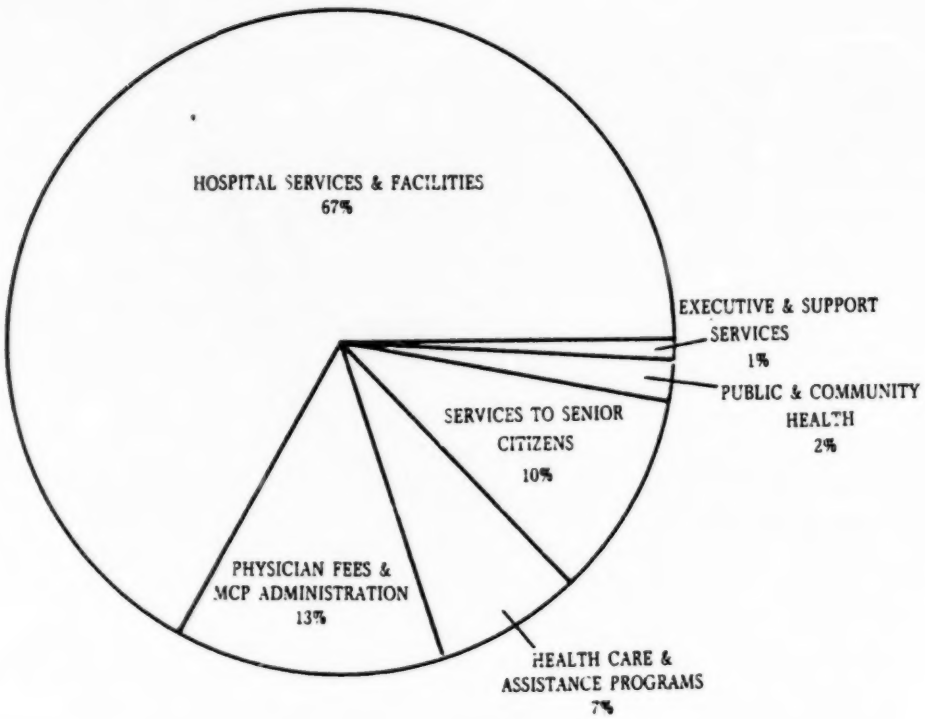
This year the Department of Health has budgeted $68.4 million for fee-for-service physicians under MCP; $2.3 million for administration of MCP; and $0.9 million for rural medical care at the district medical officer level.

3. Services to Senior Citizens ($56.0 million)

These services include amounts paid primarily to operate nursing homes and boarding homes across the Province ($50.6 million) as well as community-based services and Special Care Services.

CHART I

Where The Money Goes
1985-86



4. **Health Care and Assistance Programs ($36.8 million)**

These expenditures cover the Senior Citizens Drug Subsidy Program, the Indigent Drug Program, the Children's Dental Program, the Ambulance Program, as well as grants to various agencies such as Memorial University School of Medicine and the Newfoundland Cancer Treatment and Research Foundation.

5. **Public and Community Health ($10.6 million)**

These services comprise various programs aimed at preventing disease and promoting and protecting health. They include public health nursing, health inspection, school health, immunization, health promotion and nutrition, family planning and child health.

6. **Executive and Support Services ($3.7 million)**

These expenditures cover the department's senior planning, policy, evaluation and administrative activities as well as the cost of operating a Vital Statistics Registry and a Medical Supply Centre.

What are some examples of services which are provided for our health dollars?

TABLE II

Selected Health Services, 1984 - 85

	(number)
HOSPITAL BEDS	3,700
NURSING HOME BEDS	2,300
HOSPITAL ADMISSIONS	90,000
DAYS STAYED IN HOSPITAL	750,000
BIRTHS	10,500
OUT-PATIENT VISITS	950,000
X-RAYS (Radiology examinations)	450,000
DRUGS (Prescriptions)	1,200,000
DENTAL SERVICES (Children)	390,000
AMBULANCE TRIPS	28,000
PUBLIC HEALTH NURSING VISITS	48,000
PUBLIC HEALTH INSPECTION VISITS	58,000
DOCTORS' (Office & Clinic) VISITS (fee-for-service)	2,900,000
EMPLOYEES IN HOSPITALS	10,500
EMPLOYEES IN NURSING HOMES	2,000

How have health care costs grown over the past few years?

Health care costs over the past 5-10 years have increased at rates faster than most other services supplied out of public funds. The combination of these rising expenditure requirements and the lower growth in provincial revenues, especially in federal transfers, has placed great strain on the budget of Government.

The areas in which costs have increased most sharply are:

(1) Hospital Services and Facilities;

(2) Physician Fees and MCP Administration: and,

(3) Services to Senior Citizens.

These three items constitute 90% of the total health budget. The following table demonstrates these cost increases over the five-year period prior to the freeze period for hospital operating budgets, as recommended by the Royal Commission, and prior to the wage freeze instituted by the Government. The increases during the subsequent years are also given.

TABLE III

Major Health Care Cost Components
1979-80 to 1985-86

	1979-80	1980-81	1981-82	1982-83	1983-84	1979-80 to 1983-84 Avg. Annual Growth Rate	1984-85	1985-86	1983-84 to 1985-86 Avg. Annual Growth Rate
	($ millions)					(%)	($ millions)		(%)
Hospital Services and Facilities	191.8	222.5	262.5	313.2	340.7	15.4	341.3	360.6	2.9
Physician Fees and MCP Admin.	33.1	40.4	45.2	54.1	61.6	16.8	69.1	71.7	7.9*
Services to Senior Citizens	29.2	32.4	37.1	41.1	45.8	11.9	46.3	56.0	10.6

* Physician fees did not come under the two-year freeze until November, 1984.

What have been the major factors contributing to this high growth?

The following factors contributed most to increases in the above expenditure categories during the years prior to the freeze years:

- Increases in the number of hospital staff;
- Salary increases for hospital and nursing home staff;
- Increases in the number of physicians;
- Increases in the fee schedules and in salaries for physicians;
- Increases in the rate of utilization of laboratory, X-ray and hospital services by physicians; and,
- Increases in the number of nursing homes and nursing home beds.

CHAPTER II

FEDERAL/PROVINCIAL HEALTH CARE FUNDING

What is the constitutional basis for the funding of health care?

Under Section 92 of the Canada Act, Canada's Constitution, the provinces are charged with the responsibility for providing health care. However, the expenditures constitutionally required of provincial governments exceed the revenue raising ability available to them. To help offset this imbalance a system of fiscal transfers has been developed by the Federal Government in consultation with the provinces. Federal transfers to Newfoundland in 1985-86, including the Fiscal Equalization Program and the Established Programs Financing (EPF) arrangements, represent 47 percent of the Province's current account revenues, or $853 million.

How does the Government of Canada support the financing of provincial health care services?

Federal financial support for provincial health services is authorized under the EPF arrangements as well as under the Canada Health Act which specifies the conditions governing federal funding. EPF was introduced in 1977 under which funds are transferred to each province in block amounts replacing provincial programs funded on a cost-shared basis with the Federal Government up to that time. Under the current federal/provincial arrangements, EPF transfers by the Government of Canada are paid equally per capita across the country. (For a detailed explanation of the EPF arrangements please refer to Appendix, page 21).

How well does EPF perform in supporting the provincial health care system – past, present and future?

EPF is designed to provide financial support to both provincial health care programs and post-secondary education so that all residents of Canada have reasonable access to these services. When EPF was implemented in 1977-78, it embodied two basic principles — financial certainty and blockfunding. It was designed to provide a stable and predictable level of federal support which would increase in relation to the economic well-being of the country. The blockfunding principle applying to both health care and post-secondary education services was looked upon as one that would give the provinces greater flexibility in the planning and administration of these particularly costly program areas.

Since the inception of the EPF arrangements there have been two significant adjustments to the program which have compromised these principles. These modifications involved the termination by the Federal Government of an important component of the transfers in 1982-83 and the subsequent placement of an arbitrary ceiling on the growth rate of a portion of the EPF blockfund during the "6 and 5" federal restraint period. The combined effect of these adjustments over the 1982-83 to 1986-87 period is a reduction, estimated at $144 million, in EPF transfers to this Province.

The future of the EPF arrangements is further clouded because the Federal Government has affirmed its intention to reduce the rate of growth in transfers to the provinces by $2 billion annually by the end of the decade. As of April, 1986 EPF will be the target of the federal savings. This restraint measure, it is estimated, will reduce the growth in EPF transfers to Newfoundland by a total of $128 million over the next five years, or an average of over $25 million per annum over that period. These expectations are placing much increased pressure on provincial budgetary management. (For further information see Appendix, page 21.)

It is interesting to view the impact of these latest reductions in EPF in combination with the other reductions imposed by the Federal Government since 1977. These earlier adjustments will reduce the growth of EPF transfers by an average of $40 million annually up to 1990-91. The cumulative effect of these reductions in the growth of EPF will be a decrease in transfers to the Province of approximately $65 million per annum over the next five years. (See Appendix for elaboration.)

What impact does the Canada Health Act have on the financing of the health care system?

The Canada Health Act, proclaimed in 1984, prescribes conditions which the provincial health care system must satisfy in order to qualify for the EPF transfer payment for health care. The criteria include the following: public administration, comprehensiveness, universality, portability and accessibility.

The Canada Health Act does not permit the imposition of user charges for purely medical services by hospitals or extra-billing by physicians. Failure to comply with these conditions results in a reduction of the EPF contribution by an amount equal to the revenue derived from the user fees and/or extra-billing.

What other provincial sources of funding have been used to support the health care system?

The Province does not dedicate any of its taxes or fees to the provision of health services. As is the normal practice of all provinces in Canada, funds required for health care or for any other expenditure area of Government are provided through the Province's general revenue fund and, as necessary, through its borrowing program. The Province's general revenues include personal and corporate income taxes, consumption taxes, (for example, retail sales tax and gasoline tax), resource industry taxes and a range of licences and fees.

Other provinces have developed a variety of revenue measures in response to rising health costs. For example, Ontario, Alberta and British Columbia impose a system of health insurance premiums. Quebec and Manitoba impose payroll taxes. British Columbia levies a personal income surtax. The Manitoba payroll tax and the British Columbia and Ontario personal income surtaxes were introduced to help offset the reduction in the growth of EPF transfers by the Government of Canada.

What does all this mean for me as a taxpayer and a user of health care services?

Newfoundland's capacity to generate revenues from its tax base is the weakest in the country. This partially explains why the Province's tax rates are relatively high (see Table VI, page 16). The cost of providing services in Newfoundland is relatively high also because of our geography and scattered population. Consequently, a taxpayer in this Province must bear, either directly or indirectly, a comparatively heavier tax burden in order to enjoy a level of health care services which may be available in some other provinces.

CHAPTER III

RATIONALIZATION OF HEALTH CARE— A LONG-TERM VIEW

What is being done to improve the efficiency of the health care system and thereby ease the pressure for increased funding?

During the past five years the Government of Newfoundland and Labrador has put in place a number of measures to control expenditures which are targeted at increasing the efficiency of the health care system in the Province. Some of these measures were recommended by the Royal Commission on Hospital and Nursing Home Costs which reported in February, 1984. Examples are:

- implementing global budgeting for hospitals (that is, allowing each hospital to decide its most efficacious spending pattern within the limit of a predetermined budget) to promote better management of resources at the local level (to be extended to nursing homes in 1986-87), but not permitting budgetary deficits;
- freezing all hospital and nursing home budgets at the 1983-84 level for one year, and those of hospitals in St. John's for a further two years;
- freezing salaries as well as fees for physicians and other medical professionals for two years (in common with salaries throughout the Newfoundland Public Service);
- increasing charges for elective private and semi-private accommodation in hospitals;
- implementing an incentive plan to encourage hospitals and nursing homes to save by allowing them to retain a significant portion of the savings;
- closing two outdated and inappropriately utilized hospitals (Markland and Northwest River), and replacing them through outpatient clinics, and changes in the service roles of other hospitals (e.g. Buchans);
- expanding home care and community support services, which are more cost-effective strategies than institutionalization;
- rationalizing the distribution of clinical services in regional hospitals;
- fostering the concept of multi-unit management for operational efficiency and effectiveness (for example, two or more institutions operating under one board and combining services);
- increasing the co-pay fee under the Children's Dental Program; and,
- deleting over-the-counter drugs from the list of benefits under the Indigent Drug Plan.

Can more be done?

More is being done. The Royal Commission on Hospital and Nursing Home Costs made a total of 217 recommendations aimed at increasing the cost-effectiveness of a broad range of health care activities. Government has adopted this report as a blueprint for future decision-making on such sensitive matters as further reductions in the number of out-moded acute care beds in the Province.

What effect does a gradually aging population have on a health care budget?

Changes in the size and age distribution of a population affect not only the demand for health services but also the size of the workforce available to fund required health services. Table IV below presents a projection of likely population change for the period 1986-2001.

By the year 2001 the size of the 65+ age group will be 10.9% of the population, as compared to 8.8% of the population projected for 1986. As noted in the Report of the Royal Commission on Hospital and Nursing Home Costs, the number of people in the 65+ age category may be small but their impact on health care is significant since subtle changes in their numbers can have an "exponential" effect on the demand for health care. As the life expectancy of the Newfoundland population continues to rise, the incidence of incapacitating chronic illnesses also rises, thereby increasing the need for more health care.

TABLE IV

Newfoundland and Labrador
Population Projections By Age
1986-2001

	Population Projections				% Distribution			
Age Group	1986	1991	1996	2001	1986	1991	1996	2001
0-14	155,940	145,090	136,830	125,860	26.73	24.38	22.87	20.91
15-44	283,800	288,430	275,020	260,790	48.65	48.47	45.98	43.32
45-64	92,370	104,620	124,750	150,070	15.83	17.58	20.86	24.93
65-74	32,800	33,980	35,190	36,600	5.62	5.71	5.88	6.08
75-84	14,700	18,730	21,200	22,000	2.52	3.15	3.54	3.66
85+	3,800	4,190	5,180	6,700	0.65	0.70	0.87	1.11
65+	51,300	56,910	61,570	65,300	8.79	9.56	10.29	10.85
TOTAL	583,410	595,040	598,170	602,020	100.00	100.00	100.00	100.00

SOURCE: Royal Commission on Hospital and Nursing Home Costs, February, 1984.

Does Government still have to meet strong regional demands for new modern institutions and health care professionals?

The Government is committed to a policy of ensuring that adequate health care services are available in all regions of the Province to avoid unnecessary long-distance referrals for specialty services, and to respond to changing technologies. During the past five years capital expenditures on new and up-graded hospital facilities totalled almost $69 million (see Table V below).

TABLE V

Capital Expenditures
Health Facilities
Total 1981-82 to 1985-86

	($ million)
Additional Major Facilities	42.0
New Community Clinics	3.3
Upgraded Facilities	18.2
Other	5.2
TOTAL	68.7

The May 1985 Budget contains examples of health care capital expenditures which address not only the regional needs for health care facilities but also the special chronic care needs for our gradually aging population:

- A $16 million redevelopment program for the Central Newfoundland Hospital at Grand Falls, of which $2 million could be spent in 1985-86;
- A further $7 million for the $16 million hospital on the Burin Peninsula;
- A final $1.8 million to complete construction of the new $15.5 million hospital in Clarenville;
- $1 million to initiate the planning and construction of a new 75-bed chronic care facility at Botwood;
- The conversion of the Buchans hospital to a chronic care institution;
- $3.6 million for major upgrading and extension of the Harbour Lodge chronic care facility in Carbonear;
- Completion of a 60-bed extension and upgrading at St. Patrick's Mercy Home in St. John's;
- Completion of a 50 nursing bed extension to Lakeside Homes in Gander;
- Completion of a new 75-bed senior citizens home in Placentia; and,
- Completion of a 50-bed extension for the Bay St. George Nursing Home.

These projects, and others which were carried out over the previous five years, substantially fulfill a long-term plan to remedy deficiencies in institutional services in many regions of this Province.

The Government is also taking every reasonable action possible to attract and retain health care professionals in all regions of the Province. It is believed that the rationalization of services through multi-unit arrangements and regionalization will serve this objective.

CHAPTER IV

FINANCING HEALTH CARE — IMMEDIATE CONCERNS

What are the immediate concerns confronting the Government of Newfoundland and Labrador in financing the health care system?

Any fiscal decision affecting the health care system, either on the expenditure side or the revenue side of the total budget of the Newfoundland Government, must be made within the context of a number of constraining budgetary pressures. The Government is experiencing:

- A declining trend in current account revenue growth (see Chart II below);
- Continuing declines in the expected rates of growth in federal transfers (see Chart III below and Appendix, page 21);
- A heavily burdened tax system, and a fiscal capacity which is the lowest of any province in Canada (see Tables VI, page 16 and VII, page 18);
- Per capita debt levels which are among the highest in Canada, despite recent growth rates which have been kept among the lowest in Canada; (see Chart IV, page 13); and,
- Pressing demands for new funds not only from health care and post-secondary education but also from other expenditure areas of Government such as primary and secondary education, social services and the resource departments (see Chart V, page 13).

CHART II

Current Account Revenue Growth Rates

1978-79 to 1985-86

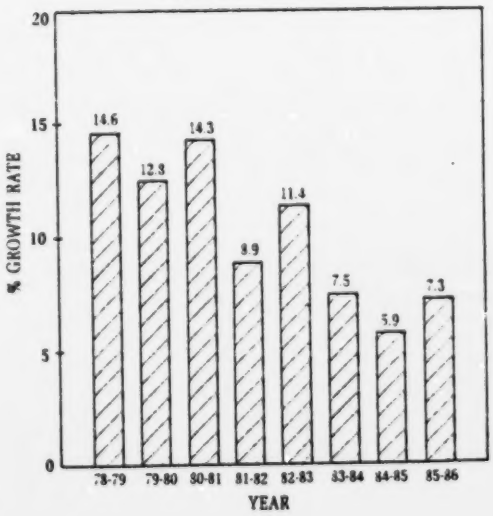


CHART III

Nfld. EPF Entitlements Growth Rates

1978-79 to 1985-86

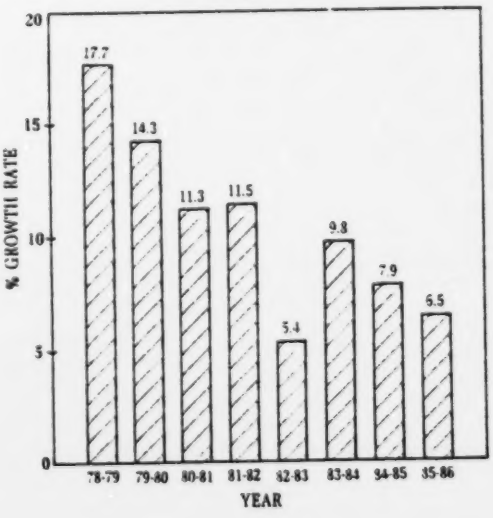


CHART IV

Nfld. Per Capita Public Sector Debt Growth Rates 1978-79 to 1985-86

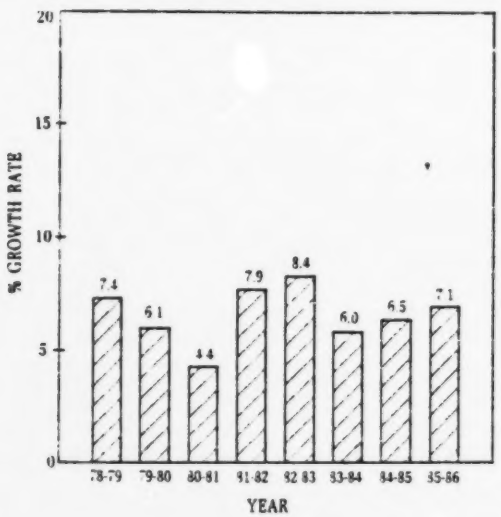
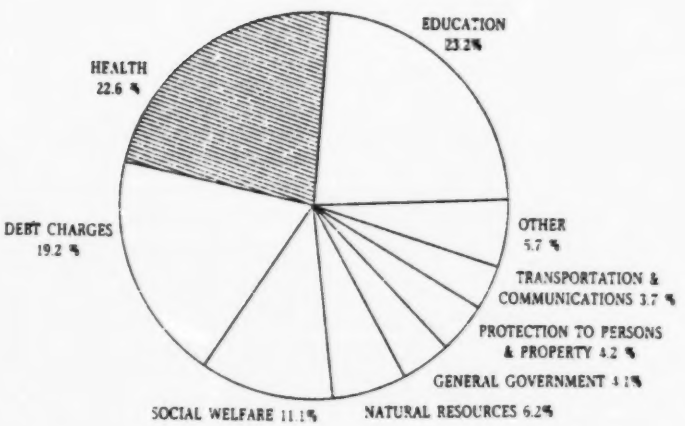


CHART V

Current Account Expenditures 1985-86

($2,102 Million)



Is Newfoundland and Labrador the only area of the country grappling with health care financing issues?

Definitely not. All provinces in the country are experiencing significant difficulties with the financing of their health care programs, especially as they face the reduction in the rate of growth in EPF transfers by the Federal Government. In recent years, there have been bed closures in hospitals throughout the country, budgetary increases for operating and equipment requirements have been kept below the annual inflation rate and new tax measures to help finance health care services have been introduced.

What options could be considered by Government to deal with the problems of financing the health care system?

A number of options are available to Government. Four options are considered in this paper:

- Privatization, in whole or in part, of the health care system through either private ownership, management or funding;
- Changes in health care expenditures beyond those recommended in the Royal Commission on Hospital and Nursing Home Costs;
- Deficit financing; and,
- The tax system.

CHAPTER V

POLICY OPTIONS

Privatization

Should the Government consider the private sector as an alternative to manage and fund aspects of the health care system?

There is much discussion across the country at present about the privatization of the health care system. In some provinces, such as Ontario, and in the United States, private enterprise operates a number of hospitals and nursing homes.

In the Province of Newfoundland, private enterprise traditionally has not played a major role in management of the health care system although some private organizations have successfully managed dietetic and housekeeping services in a number of the Government's institutions.

Opinions have been expressed on the one hand that since private enterprise is oriented towards the profit motive, patient and resident care and quality of service will suffer as a result. Private enterprise, on the other hand, maintains that it can be just as caring as the public sector, yet provide services in a more cost-effective manner.

Should the Province re-institute user fees and introduce extra-billings?

Until recently, hospitals had a user fee of $5.00 per day up to a maximum of $75.00 per year for patients admitted to the general wards. However, these user fees were eliminated on the advice of the Royal Commission on Hospital and Nursing Home Costs and prior to passage of the Canada Health Act. User fees for purely medical services are not permitted within the provincial health care systems, according to the Canada Health Act, without a comcomitant reduction in federal transfer payments.

Physicians have rarely extra-billed patients for office visits in this Province in the past unlike physicians in other provinces. Further, the recent Canada Health Act states that if provinces allow their physicians to extra-bill patients, there will be a corresponding reduction on a dollar-for-dollar basis in federal transfer payments.

Health Care Expenditure Cutbacks

Can major savings be achieved in the health care area (beyond those being attained by implementing the Royal Commission recommendations) which will not have a negative impact on the general health or health status of the population?

Expenditure restraint has been an element of all recent provincial budgets. This restraint has been applied to hospitals and institutions as well as other areas of expenditure. Government and the health care institutions have been working together to use scarce funds in as cost-effective a manner as possible. The financial outlook is such that expenditure restraint, in one form or another, will remain with us for a while. In that context, Government as well as hospitals and institutions will have to stand shoulder to shoulder in their intensive efforts to achieve greater cost-effectiveness within budgets that suffer from severely constrained financial resources.

The question is how far these restraint measures can go without reducing the health status of the population. Clearly, money could be saved by providing fewer services. The impact of such measures on the population's health status would depend on the degree of restraint applied in subsequent budgets. The more severe the reductions, the closer we can come to the point where health status could suffer. At the same time, reduced expenditures could result in layoffs, delays in providing services, and difficulties in recruiting and retaining professional staff.

Deficit Financing

Should Government consider further deficit financing as a means to fund ongoing health care costs?

Capital costs in the area of health care and in all other capital expenditure areas of Government, have traditionally been financed through borrowing. Insofar as surpluses have been available on Government's current or operating accounts, these have been used to reduce the amount to be borrowed.

It has been the normal practice of Government to finance operating (current account) expenditures through operating (current account) revenues. Unfortunately, over the past four fiscal years this has not been possible. Operating deficits have become a problem common to many governments in Canada. The recent recession has held back the growth in governments' tax revenues while growth in operating expenditures generally could not be curtailed enough to offset the losses in revenue.

Recurring operating account deficits are having a burdensome cumulative impact on Government's annual debt charges and should not be allowed to become a permanent feature of the budget. In 1985-86 the debt charges of Government were just over $400 million, or almost one-fifth of total current account expenditures.

Deficit financing of operating expenditures, however, would allow Government to continue to provide essential services without tax increases, but only in the short run.

Tax System

What are the fundamental principles of a tax system?

According to taxation theory, taxes should conform to five, often conflicting, principles. These are equity, efficiency, neutrality, certainty and convenience. These principles are defined as follows:

TABLE VI

Provincial Tax Comparison
(General Rates)

January 1, 1986

	PERSONAL INCOME TAX		CORPORATE INCOME TAX		CORPORATION CAPITAL TAX			RETAIL SALES TAX	FUEL TAX		LIQUOR PRICE COMPARISON (5)
	RATE	SURTAX (6)	REGULAR	SMALL BUSINESS	GENERAL COMPANIES	BANKS	LOAN/TRUST COMPANIES		GAS	DIESEL	
Newfoundland	60.0%	-%	16.0%	10.0%	-%	1.50%	1.50%	12%	22.0%	26.0%	$16.30
Prince Edward Island	52.5	-	10.0	10.0	-	-	-	10	20.0	23.0	17.50
Nova Scotia	56.5	-	15.0	10.0	-	-	-	10	20.0	21.0	16.20
New Brunswick	58.0	-	15.0	5.0	-	-	-	11	20.0	23.0	15.20
Quebec	(1)	-	5.5	3.0	0.45	0.90	0.90	9	30.0	30.0	15.09
Ontario	50.0	3.0	15.5	10.0	0.30	0.80	0.60	7	19.0	24.0	14.95
Manitoba	54.0	20.0	16.0	10.0	0.20	1.90	0.60	6	20.0	24.3	15.50
Saskatchewan	50.0	12.0 (2)	16.0	10.0	0.30	2.00	0.80	5	-	-	15.45
Alberta	43.5	-	11.0	5.0	-	-	-	-	-	-	13.15
British Columbia	47.5 (4)	10.0	16.0	8.0	0.20 (3)	2.00	0.60	7	20.0	20.0	14.20

(1) Quebec maintains its own Personal Income Tax system which differs from the Federal system.

(2) In addition to the Surtax shown, a "Flat Tax" was introduced at the rate of 1% of Net Income, effective July, 1985.

(3) To be phased out over three years starting April, 1985 except as it applies to banks with head offices outside B.C.

(4) Includes the effect of a Health Care Maintenance Surtax at 8% of Provincial Personal Income Tax payable.

(5) Prices shown are for a popular light rum; the relative price differences among Provinces are generally consistent across the range of products.

(6) Rate applied on Provincial Personal Income Tax payable equal to or greater than: Ontario - $5,000; Manitoba - $2,715; Saskatchewan - $4,000; British Columbia - $3,500.

EQUITY — Equals should be treated equally. Embodied within the equity principle are two other (often conflicting) principles: the Benefit Principle which argues that taxes should be paid in accordance with the benefits received from government expenditures; and the Ability to Pay Principle which argues that taxes should be based on the taxpayer's ability to pay.

EFFICIENCY — Collection costs should be minimized for government and compliance costs should be minimized for taxpayers.

NEUTRALITY — Taxes should not distort individual choices and hence impede the ability of the free market system to allocate resources efficiently.

CERTAINTY — A taxpayer should be able to assess his own tax liability with relative ease and government should be able to anticipate the revenues it has forecast.

CONVENIENCE — The time and manner of payment should be made as troublefree as possible for the taxpayer.

Why are our rates as high as they are?

There are three main factors which help to explain this Province's high income and consumption tax rates relative to most areas of Canada (see Table VI, page 16):

(i) Our lower fiscal capacity;

(ii) Our provincial expenditures which include items traditionally financed by municipal/local governments in some other areas of Canada; and,

(iii) Our lower resource taxes.

These three factors are explained in more detail below.

(i) Our Lower Fiscal Capacity

Newfoundland's fiscal capacity, which is really our revenue-generating capacity, is defined as a relative measure of our ability to derive revenues from our revenue base. It is not difficult to understand that when average incomes in the Province are only two-thirds of the national average, and unemployment rates are double the national average, our yields from taxes will be correspondingly lower. Currently our per capita fiscal capacity is only 60 percent of the national average. The fiscal capacities of each of the provinces, expressed as a percentage of the national average, are listed in the following table.

TABLE VII

Fiscal Capacity by Province, 1985-86

	(%)
Newfoundland	60
Prince Edward Island	61
Nova Scotia	72
New Brunswick	67
Quebec	79
Ontario	98
Manitoba	81
Saskatchewan	105
Alberta	200
British Columbia	104
National Average	100

(ii) Provincial/Municipal Interface

As Table VI (see page 16) shows, most of the consumption and income tax rates in Newfoundland are higher than those of the other provinces. This has resulted in part because of the much slower development of the municipal and regional systems of government in the Province. As a consequence of the void left by local governments, the Provincial Government has been required to take responsibility for some of the functions which, in other parts of Canada, are often addressed by municipalities: education, transportation, and police services for example. This in turn has placed an extra burden on the Provincial Treasury to fund the broader package of services via higher tax rates.

(iii) Our Lower Resource Taxes

The Province's fiscal capacity to collect natural resource revenues is relatively weak, only one quarter of the national average. This is mainly attributable to the relatively low level of economic rent accruing to the Province from water power rentals. The Province carries an overwhelming economic rent loss in revenue from this source. In 1985-86, Government revenues from this source are estimated at $30,000. An estimate by the Economic Council of Canada in 1984 shows the loss in economic rent to the Province from the 65-year Churchill Falls power contract to be approximately $600 million annually.

What are the major tax sources of the Newfoundland Government?

The largest and probably the most visible tax revenue source is Retail Sales Tax (RST). In 1985-86 Government has budgeted RST revenues of $370 million.

The next most important provincial tax revenue source is Personal Income Tax with a 1985-86 budget of $270 million. Newfoundland's personal income tax burden is the second highest in Canada after Quebec's.

The profits earned by the Newfoundland Liquor Corporation are in most respects a tax; a 1985-86 budgeted profit of $71 million makes this the third largest provincial revenue source.

The fourth largest provincial tax revenue source is Fuel Tax which includes gasoline, diesel, and propane. The 1985-86 budgeted revenue from this source is $70 million. At 22 percent, our rate on gasoline is higher than in most areas of Canada.

Corporate Income Tax is the fifth largest tax revenue from provincial sources, with a 1985-86 budget of $45 million. The Province's tax rate of 16 percent for large corporations is equal to that in Manitoba, Saskatchewan, and British Columbia. Other provinces have lower rates. Newfoundland's tax rate for small corporations was reduced to 10 percent in 1984 and is now the same as the rates in five other provinces. Government is encouraging the further development of small business in the Province with the reduced rate.

The sixth largest revenue source is Tobacco Tax which is budgeted at $43 million for 1985-86.

Mining Taxes and Royalties comprise the seventh largest revenue source with a 1985-86 budget of $23 million.

In 1985-86, Fees and Licences will yield a total revenue of approximately $38 million. Of this amount, the Department of Transportation will generate about one half, principally through motor vehicle licencing.

What are the major tax exemptions provided by the Newfoundland Government?

Most tax exemptions provided by the Government of Newfoundland and Labrador occur in the area of Retail Sales Tax. Some gas and diesel exemptions and other exemptions are provided but they are minor in comparison with RST. Many of the RST exemptions are provided to the manufacturing and resource industries in order to help make these industries more competitive, to stimulate business development and to create badly needed jobs. An example is the reduced rate of 8 percent on building materials which was introduced as a temporary measure to help stimulate the construction industry.

A variety of personal RST exemptions are made available to overcome the regressivity (an undue burden on low-income groups) of RST. All provinces in Canada provide basic exemptions from RST primarily to reduce the tax burden on low-income families.

What are some examples of additional tax measures imposed in other provinces?

Four examples are listed below:

(i) Personal Income Surtax

(ii) Corporate Capital Tax (all corporations)

(iii) Health Insurance Premiums

(iv) Payroll Tax

Conclusion

There are no options which are particularly attractive to Government to help finance the health care system. A number have been reviewed in this chapter to stimulate discussion on the wider range of options possible. The present tax system has been briefly explained to provide a fiscal framework in which to assess these options. Government is now seeking your reaction to this Green Paper and your views on possible options for financing the health care system.

APPENDIX

THE EPF ARRANGEMENTS — HEALTH CARE AND POST-SECONDARY EDUCATION

The EPF arrangements were introduced in 1977 as a means to provide federal financial support for provincial health and post-secondary education programs. This blockfunding approach replaced the cost-sharing arrangements which existed prior to 1977. Under the EPF arrangements, a formula-determined transfer of cash payments is made and the provinces are given increased responsibility for generating income tax. The value of the EPF transfer is determined in relation to the national average per capita expenditure for the three "established" programs in the 1975-76 (base) year. The established programs are Hospital Insurance and Medical Care, (now combined to form Insured Health Services), and Post-Secondary Education. A further cash transfer is made under the EPF arrangements for Extended Health Care Services.

In calculating the provincial EPF entitlement in 1975-76, the Federal Government considered three elements: the cash contribution, the tax transfer and the equalization associated with the tax transfer. The EPF cash component is calculated on the basis of the tax transfer and the associated equalization. With the inception of the EPF arrangements the Federal Government created tax room equivalent to 13.5 personal income tax points and 1.0 corporate income tax point and the provinces increased their tax rates to collect the available revenue through the provincial income tax systems. For the less affluent provinces, such as Newfoundland, the transferred tax points are equalized under the Fiscal Equalization Program.

The total EPF entitlement, including the transferred tax points and associated equalization, is equal per capita across the country. The total entitlement is equal to the per capita contribution to health and post-secondary education in the 1975-76 base year escalated by the EPF escalator and multiplied by the provincial population. The EPF escalator is a three-year moving average of per capita Gross National Product. (In 1983-84 and 1984-85 the growth of a portion of the EPF transfer was subjected to the "6 & 5" federal restraint program.)

The EPF cash contribution is equal to the total EPF transfer minus the value of the transferred tax points and the associated equalization. The Federal Government transfers an additional cash entitlement under the EPF arrangements for extended health care services which is computed as $20 per capita escalated from 1977-78 on the basis of the EPF escalator. The following table shows how the 1985-86 Newfoundland EPF entitlement is determined.

TABLE A-1

Calculation of the 1985-86 Newfoundland EPF Entitlement

($ millions except where noted)

1. Entitlement for Established Programs (per capita)	$579
2. Newfoundland Population (persons)	580,700
3. Total EPF Entitlement (1 × 2)	$336
4. Value of Transferred Income Tax Points	$ 71
5. Value of Associated Equalization	$ 57
6. EPF Cash Entitlement (3 minus 4 and 5)	$208
7. Extended Health Care Cash Contribution (per capita)	$ 42
8. Total Extended Health Care Cash Entitlement (2 × 7)	$ 24
9. Total EPF Cash Entitlement (6 + 8)	$232*

* This entitlement of $232 million differs from that shown in the 1985 Newfoundland Budget. The Budget data are presented on a cashflow basis and include cash adjustments for re-estimates of entitlements due for previous years.

Modifications of the EPF Arrangements

There have been two significant modifications to the EPF program since its inception in 1977-78. One such modification occurred in 1982-83 with the arbitrary termination of the revenue guarantee component of the program. While the revenue guarantee component was related to income tax reform, it formed an integral part of the 1977 EPF negotiations. The revenue guarantee was equal to the value of one personal income tax point plus its cash equivalent which represents approximately $26 million to the Province this year. With the elimination of the revenue guarantee the Federal Government recovered the total value through the EPF cash entitlements.

A second adjustment to the EPF arrangements involved the placement of a growth rate ceiling on a portion of the EPF blockfund allocated to post-secondary education by the Federal Government. This portion of the transfer was restricted to a federal "6 & 5" restraint policy in 1983-84 and 1984-85.

The following table illustrates the estimated financial impact of these adjustments on EPF transfers to Newfoundland over the 1982-83 to 1986-87 period.

TABLE A-2

Estimated Newfoundland Losses Attributable to Modifications to the EPF Arrangements

	1982-83	1983-84	1984-85	1985-86	1986-87	Total
			($ millions)			
Termination of Revenue Guarantee Component	21	23	24	26	28	123
Growth Rate Cap	—	2	6	6	7	21
Total Losses	21	25	30	33	35	144

Notes: 1. Totals may not add due to rounding.

2. The average annual loss from 1982-83 to 1986-87 is approximately $29 million. Over the next five years, up to 1990-91, the average annual loss is expected to be $40 million.

Future Federal Restraint

The future role of the EPF arrangements in supporting the provincial health care and post-secondary education systems remains unclear. The Federal Government has indicated its intention to reduce transfers to the Provinces by $2 billion by the end of the decade. It is now apparent that the EPF program is to be the target of the restraint policy which will commence on April 1, 1986. This federal restraint initiative entails an estimated annual reduction in the Province's EPF entitlement of $46 million by 1990-91. The cumulative EPF losses over the 1986-87 to 1990-91 period will be substantial with Newfoundland losing $128 million over the five-year period.

TABLE A-3

Projected Reductions of EPF Transfers to Newfoundland 1986-87 to 1990-91

	1986-87	1987-88	1988-89	1989-90	1990-91	Total
			($ millions)			
EPF Reduction	7	16	24	35	46	128

This analysis would be incomplete if in the consideration of future federal restraint it neglected the continuing implications of federal restraint measures implemented during the 1982-83 to 1984-85 period. The projected EPF losses of $128 million given above, or an average of $25 million per annum, would be incremental to those continuing EPF losses effected through earlier federal restraint initiatives. It is possible to demonstrate the gravity of the earlier restraint by conservatively projecting the impact of these restraint measures, illustrated in Table A-2, and adding it to the Newfoundland share of the current $2 billion federal restraint policy. The earlier restraint measures averaged $29 million per annum in reduced revenues from 1982-83 to 1986-87. Over the five years from 1986-87 to 1990-91 the same restraint measures will average approximately $40 million per annum, (see note 2, Table A-2), a significant drop from the level of EPF funding which would have been available under the original EPF arrangements. In fact, the Province can anticipate an average annual decrease in the growth of EPF of $65 million over the next five years.